



BERBERICH TRAHAN & CO., P.A.

Certified Public Accountants

EL PASO WATER COMPANY, INC.
CITY OF DERBY, KANSAS

FINANCIAL STATEMENTS
WITH SUPPLEMENTARY INFORMATION
YEARS ENDED DECEMBER 31, 2009 AND 2008

EL PASO WATER COMPANY, INC.
CITY OF DERBY, KANSAS

FINANCIAL STATEMENTS
WITH SUPPLEMENTARY INFORMATION

Years Ended December 31, 2009 and 2008

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INDEPENDENT AUDITORS' REPORT

El Paso Water Company, Inc.
City of Derby, Kansas

We have audited the accompanying balance sheets of El Paso Water Company, Inc. (the Company) as of December 31, 2009 and 2008, and the related statements of income, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects, in relation to the basic financial statements taken as a whole.

Berberich Trahan & Co., P.A.

July 19, 2010

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EL PASO WATER COMPANY, INC.
CITY OF DERBY, KANSAS

BALANCE SHEETS

December 31, 2009 and 2008

	2009	2008
<u>ASSETS</u>		
Utility plant:		
Land and land improvements	\$ 75,059	\$ 75,059
Wells, pumphouses and equipment	983,222	983,222
Mains and storage tanks	4,457,556	4,457,556
Meters	2,365,970	2,251,195
Warehouse building	58,954	58,954
Office furniture and equipment	24,113	24,113
Automotive and other equipment	234,789	227,131
	8,199,663	8,077,230
Less allowance for depreciation	(5,545,384)	(5,305,777)
Total	2,654,279	2,771,453
Current assets:		
Cash	340,489	381,930
Accounts receivable	166,152	143,515
Unbilled receivables	101,244	108,728
Materials and supplies	24,483	33,976
Prepaid insurance	17,372	14,200
	649,740	682,349
Total current assets	649,740	682,349
	\$ 3,304,019	\$ 3,453,802

See accompanying notes to financial statements.

	<u>2009</u>	<u>2008</u>
<u>LIABILITIES AND STOCKHOLDER'S EQUITY</u>		
Current liabilities:		
Accounts payable	\$ 116,535	\$ 80,942
City of Wichita - take or pay	205,158	188,553
Payables to the City of Derby	241,773	241,553
	<u>563,466</u>	<u>511,048</u>
Stockholder's equity:		
Common stock, no par value, stated value \$ 25 per share: authorized 40,000 shares; issued and outstanding 34,860 shares	871,500	871,500
Additional paid-in capital	303,053	303,053
Retained earnings	2,165,991	2,368,192
	<u>3,340,544</u>	<u>3,542,745</u>
Treasury stock at cost - 3,545 shares	<u>(599,991)</u>	<u>(599,991)</u>
	<u>2,740,553</u>	<u>2,942,754</u>
Total stockholder's equity	<u>\$ 3,304,019</u>	<u>\$ 3,453,802</u>

EL PASO WATER COMPANY, INC.
CITY OF DERBY, KANSAS

STATEMENTS OF INCOME

Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Operating revenues	<u>\$ 2,786,977</u>	<u>\$ 2,720,923</u>
Operating expenses:		
Operation and maintenance	2,005,457	1,971,071
Depreciation	<u>249,127</u>	<u>235,278</u>
Total operating expenses	<u>2,254,584</u>	<u>2,206,349</u>
Net income	<u><u>\$ 532,393</u></u>	<u><u>\$ 514,574</u></u>

See accompanying notes to financial statements.

EL PASO WATER COMPANY, INC.
CITY OF DERBY, KANSAS

STATEMENTS OF RETAINED EARNINGS

Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Balance, beginning of year	\$ 2,368,192	\$ 2,464,044
Net income	532,393	514,574
Cash dividends to the City of Derby	<u>(734,594)</u>	<u>(610,426)</u>
Balance, end of year	<u>\$ 2,165,991</u>	<u>\$ 2,368,192</u>

See accompanying notes to financial statements.

EL PASO WATER COMPANY, INC.
CITY OF DERBY, KANSAS

STATEMENTS OF CASH FLOWS

Years Ended December 31, 2009 and 2008

	2009	2008
Cash flows from operating activities:		
Net income	\$ 532,393	\$ 514,574
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	249,127	235,278
Changes in assets and liabilities:		
Accounts and unbilled receivables	(15,153)	(28,265)
Materials and supplies	9,493	1,117
Prepaid insurance	(3,172)	6,546
Accounts payable	35,593	12,586
Accrued payroll and vacation pay	-	(39,537)
Taxes, other than income taxes	-	(9,853)
City of Wichita - take or pay	16,605	80,351
Payables to the City of Derby	220	65,151
Miscellaneous payables	-	(5,465)
Net cash provided by operating activities	825,106	832,483
Cash flows from investing activities:		
Purchases of equipment	(131,953)	(146,850)
Cash flows from financing activities:		
Dividends paid	(734,594)	(610,426)
Net increase (decrease) in cash	(41,441)	75,207
Cash, beginning of year	381,930	306,723
Cash, end of year	\$ 340,489	\$ 381,930

See accompanying notes to financial statements.

EL PASO WATER COMPANY, INC.
CITY OF DERBY, KANSAS

NOTES TO FINANCIAL STATEMENTS

December 31, 2009 and 2008

1 - Nature of Organization and Summary of Significant Accounting Policies

Organization and Operations

El Paso Water Company, Inc. (the Company) is a water utility company serving customers located in Derby, Kansas. Water sales comprise the majority of the Company's operating revenues, which could be adversely affected by the amount of local rainfall, conservation measures by customers or an interruption of service from the City of Wichita water supply. On January 27, 1999, all stock of the company not redeemed as treasury stock was acquired by the City of Derby, Kansas.

Utility Plant

Utility plant assets are reflected at cost as of the time of acquisition. The Company generally capitalizes all expenditures for utility plant assets in excess of \$ 2,500.

Maintenance and repair costs are charged to income as incurred, and significant renewals and betterments are capitalized. When assets are retired or disposed of, the related costs and accumulated depreciation are removed from the respective accounts and any gain or loss is credited or charged to income.

Depreciation is provided for in amounts sufficient to charge the cost of depreciable assets to operations over their estimated service lives. For substantially all capital assets acquired prior to 1987, an accelerated method of depreciation (declining-balance) is used for financial reporting purposes, except for assets acquired prior to January 1, 1976, which are depreciated using the straight-line method for financial reporting purposes. All capital assets acquired subsequent to 1987 are depreciated using the straight-line method. Estimated useful lives are as follows:

	<u>Years</u>
Land improvements	20
Wells, pumphouses and equipment	40
Mains and storage tanks	50
Meters	5 - 15
Warehouse building	40
Office furniture and equipment	5 - 7
Other	3 - 10

EL PASO WATER COMPANY, INC.
CITY OF DERBY, KANSAS

NOTES TO FINANCIAL STATEMENTS
(Continued)

1 - Nature of Organization and Summary of Significant Accounting Policies (Continued)

Accounts Receivable and Revenue Recognition

Revenue is recognized as service is provided to customers. All customers are billed monthly.

Accounts receivable consist of both residential and commercial water sales. Unbilled receivables are recorded for services provided for which customers have not been billed at December 31, 2009. The Company utilizes the direct write-off method of accounting for bad debts. Accounts greater than 90 days past due are considered uncollectible and are written off. Management has determined that an allowance for doubtful accounts is not necessary at December 31, 2009 and 2008.

Materials and Supplies

Inventories of materials and supplies are stated at the lower of cost or market; cost is determined using the last-in, first-out method.

Income Tax Matters

The Company has received a Private Letter Ruling from the Internal Revenue Service concluding that the Company is a public utility for purposes of Internal Revenue Code 115(1) and, accordingly, its income from the operation of the public utility is excludable from taxation.

On January 1, 2009, the Company adopted the accounting standard on accounting for uncertainty in income taxes, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, the Company may recognize the tax benefit from an uncertain tax position only if it is more-likely-than-not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The guidance on accounting for uncertainty in income taxes also addresses de-recognition, classification, interest and penalties on income taxes, and accounting in interim periods. As of December 31, 2009, there were no uncertain tax benefits identified and recorded as a liability.

EL PASO WATER COMPANY, INC.
CITY OF DERBY, KANSAS

NOTES TO FINANCIAL STATEMENTS
(Continued)

1 - Nature of Organization and Summary of Significant Accounting Policies (Continued)

Income Tax Matters (Continued)

The Company files income tax returns in the U.S. federal jurisdiction and Kansas state jurisdiction. With few exceptions, the Company is no longer subject to U.S. federal or state and local income tax examinations by tax authorities for years before 2006.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities recognized and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

2 - Related Party Transactions

The Board of Directors of El Paso Water Company, Inc. is comprised of the Mayor and City Council members of the City of Derby. The Company bills and collects sewer charges for the City of Derby. The amount owed to the City of Derby for unremitted sewer charges and penalties at December 31, 2009 and 2008 was \$ 241,773 and \$ 218,758, respectively.

Effective January 1, 2008, all employees of the Company became employees of the City of Derby. The Company makes a monthly reimbursement to the City of Derby for contract labor. The total contract labor reimbursement from the Company to the City of Derby for the years ended December 31, 2009 and 2008 was \$ 397,720 and \$ 456,555, respectively. The amount owed to the City of Derby at December 31, 2008 was \$ 22,795.

The Company also leases office space from the City of Derby. Total rental expense included in operations was \$ 9,600 for each of the years 2009 and 2008.

EL PASO WATER COMPANY, INC.
CITY OF DERBY, KANSAS

NOTES TO FINANCIAL STATEMENTS
(Continued)

3 - Water Rights

As of December 31, 1996, the Company hired a consultant to prepare a business valuation of the Company. Included in the valuation were water rights with a value of \$ 851,600. This value was based upon transactions in water rights in the area. The Company does not have a cost basis in the water rights, and therefore, in accordance with accounting principles generally accepted in the United States of America, they are not reflected on the balance sheets.

4 - Commitments

In April 2004, the City of Derby issued \$ 9,455,000, 1.10% - 5.00% General Obligation Water System Refunding Bonds, Series 2004-A, with varying maturities up to December 1, 2022. The Company paid dividends to the City of \$ 734,594 and \$ 610,426 for the years 2009 and 2008, respectively, related to principal and interest payments on this bond issue. Future dividend payments to the City are anticipated in order to retire the Series 2004-A bonds.

5 - Water Purchased from City of Wichita

All water sold is purchased from the City of Wichita, Kansas under a twenty year contract. The contract agreement contains a 100% "take or pay" provision. At December 31, 2009 and 2008, the Company owed the City of Wichita \$ 205,158 and \$ 188,553, respectively, under this take or pay agreement.

6 - Subsequent Events

The Company has evaluated subsequent events through the date of the independent auditors' report, which is the date the financial statements are available to be issued.

SUPPLEMENTARY INFORMATION

EL PASO WATER COMPANY, INC.
CITY OF DERBY, KANSAS

SCHEDULES OF OPERATION AND MAINTENANCE EXPENSES

Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Contract labor	\$ 397,720	\$ 456,555
Repairs and maintenance	41,315	44,615
Truck expenses	11,253	22,171
Wichita water purchases	1,353,979	1,269,672
Electric power	14,432	17,927
Other utilities	5,451	9,577
Office supplies and postage	65,868	68,522
Rentals/operating leases	22,419	22,508
Water treating supplies	2,728	772
Insurance	18,282	20,753
Professional fees	11,922	10,463
Dues and subscriptions	1,622	2,852
Contributions	-	450
Bad debts	343	460
Payroll taxes	-	136
Other taxes	4,170	4,273
Employee benefits	-	5,493
Miscellaneous	53,953	13,872
	<u> </u>	<u> </u>
Total	<u>\$ 2,005,457</u>	<u>\$ 1,971,071</u>

See accompanying independent auditors' report.